COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Massachusetts Electric Company	)	D.P.U. 96-25

INITIAL BRIEF OF THE ATTORNEY GENERAL IN SUPPORT OF THE "CONSUMERS FIRST" SETTLEMENT AGREEMENT

RESPECTFULLY SUBMITTED
SCOTT HARSHBARGER
ATTORNEY GENERAL

by: George B. Dean
Joseph W. Rogers
William M. McAvoy
Frank P. Pozniak
Assistant Attorneys General
Regulated Industries Division

Edward G. Bohlen
Environmental Protection Division

200 Portland Street
Boston, MA 02114
(617) 727-2200

Dated: December 17, 1996

TABLE OF CONTENTS

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Massachusetts Electric Company	)	**D.P.U. 96-25**

INITIAL BRIEF OF
THE ATTORNEY GENERAL
IN SUPPORT OF THE
"CONSUMERS FIRST" SETTLEMENT AGREEMENT

I.INTRODUCTION

On October 1, 1996, the Attorney General, Massachusetts Electric Company ("MassElectric" or "the Company"), New Electric Power Company ("NEPCo" or, collectively with MassElectric, "the Companies"), the Division of Energy Resources ("DOER") and fourteen other parties, representing a broad spectrum of interests, submitted for approval by the Department of Public Utilities ("Department") an agreement designed to make "retail choice" a reality for all of MassElectric's customers on January 1, 1998. The filing followed by little more than one year the Department's initial announcement of a goal to restructure the Commonwealth's investor owned electric utility industry and its statement that it was "eager to move forward on restructuring through negotiations." *Electric Utility Restructuring*, D.P.U. 95-30, pp. 46-47 (1995). Consistent with the Department's guidance, the negotiations that produced the filing included representatives, not only of residential, commercial and industrial consumers, but also of potential new market suppliers as well as environmental and energy efficiency advocates.[1] The agreement ("Consumers First Agreement" or "Agreement"), which implements

[1] The other settling parties included representatives from all of the significant interests affected by the agreement:

the Attorney General's "Consumers First" plan for restructuring the Commonwealth's investor owned electric utility industry, provides for the following:

- freedom of choice in suppliers of power for all customers on January 1, 1998[2];
- a "standard offer" that will result in a ten percent reduction from October 1, 1996 prices for electric service and, subject to adjustments for overall inflation rates, tax law and fuel price changes, locks in the real value of that reduction until the year 2004, thereby shielding standard offer customers from market volatility for seven years;
- required divestiture by NEPCo of all of its non-nuclear generation plants and a requirement to sell, at wholesale to non-affiliates, any power from nuclear capacity that cannot be somehow transferred;
- significant reductions in air emissions at NEPCo's fossil plants in Massachusetts, continued funding demand side management and expanded renewable energy programs;
- maintenance of the current level of assistance provided to low income consumers as well as terms designed to discourage "redlining" by competitors in the emerging market.

During the course of six evening public hearings[3] and six days of evidentiary hearings held

---

customers ("Low Income Intervenors" represented by the National Consumer Law Center, the Energy Consortium, the High Tech Council, Massachusetts Community Action Directors Association); environmental and energy efficiency advocates (Conservation Law Foundation, Union of Concerned Scientists, Northeast Energy Efficiency Council); market suppliers (Northeast Energy and Commerce Association, American National Power, U.S. Generating Company, KCS Power Marketing, Inc., American Tractebel).

[2] The Agreement calls for "choice" to be available on the later of January 1, 1998 ― the date by which the Department has indicated choice should be made available to Massachusetts consumers ― or the date which retail choice is, in fact, made available to all customers of investor owned electric utilities in the Commonwealth. Exh. MECo-1, Vol. 1, pp. 21, 40-41.

[3] While only one of the six evening hearings was noticed as specifically relating to D.P.U. 96-25, the Department did receive a great deal of public comment on the Consumers First Agreement in the earlier hearings. Indeed, as was described in the Initial Comments filed earlier in this proceeding by MassElectric, during the course of these evening public hearings, the Agreement was endorsed by Associated Industries of Massachusetts, the Worcester Chamber of Commerce, Legett & Platt, Allmerica Financial, Polar Beverages, KomTek, Carruth Capital Corporation as well as by the Mayors of Gardner and Leominster. *MECO Comments*, p. 3, n. 4,

between October and December, the Department received public comment and evidence on the Consumers First Agreement. Pursuant to the procedural schedule adopted by the Department at a pre-hearing conference held on November 7, 1996, the Attorney General hereby submits his Initial Brief in which he urges the Department to approve the Agreement.

III.OVERVIEW

In his Initial Brief in support of the Consumers First Agreement, the Attorney General will set forth his arguments in favor of the Department's approval of the Agreement. These arguments are quite simple and, the Attorney General submits, quite compelling. First, the Department has the authority to approve the agreement because it is consistent with and advances the public interest, the individual statutes under which the Department operates, as well as the many restructuring principles articulated by the Department. Second, approval of the Agreement will result in real and substantial savings for consumers relative to current rates (annual savings of more than $162 million Exh. Unions 1-12.) as well as those that are likely to be put in place in the absence of this settlement. Third, in addition to immediate savings for consumers, the Agreement balances stranded cost recovery with a number of other terms that create substantial benefits for consumers that would be unlikely to be available in an adjudicated result either before the FERC or the DPU. Fourth, prompt and unconditional approval of the Agreement will permit the Department and interested parties to devote the necessary resources to the accomplishment of the manifold other actions that must be completed if Massachusetts consumers are to enjoy the benefits of competition by the Department's January 1, 1998 target date.

The Attorney General continues to adhere to his long standing opposition to utility arguments in favor of their recovery of stranded costs, but believes that the interests of Massachusetts consumers would be best served by the prompt approval of the terms of the Consumers First Agreement. The Agreement provides a real opportunity to achieve great

progress on restructuring in a prompt consensual manner, while advancing all of the Department's restructuring principles in a way that satisfies the pressing need for real savings to be made available to all consumers in the near future. The Agreement necessarily represents compromise by all parties, but it should be clear to the Department that irrespective of whether or not they signed the agreement, most of the legitimate interests of all parties affected by restructuring have been advanced to some significant extent under the terms of the Agreement. This latter fact is made evident by the lack of any substantial argument to date that the Agreement is fundamentally flawed and should be rejected.

Indeed, in light of the lack of any broad challenge to the Agreement, this brief is limited to argument on why, considered as a whole and as an alternative to protracted and uncertain litigation, approval of the Agreement will advance all parties' interests more than will continued litigation. On reply, the Attorney General will make any response he deems necessary to arguments made in favor of rejecting the settlement in the absence of conditions designed to advance an individual party's interests; advances, it is useful to note, that to date do not appear to be otherwise achievable through litigation.

While the Department must exercise its responsibility to reach its own conclusions on whether the terms of the Consumers First Agreement are "consistent with Department precedent and public policy," the Attorney General urges the Department, during the course of its deliberations on whether to approve the Agreement, to bear in mind the following facts:

- The Agreement has been endorsed by representatives of almost every significant interest that could be affected by the restructuring of the electric utility industry, including all of the major representatives of customer interests, residential and business.
- The Agreement is not only consistent with, but it advances in very material ways, all of the many restructuring principles that the Department has articulated in the past two years.
- The Agreement secures tangible benefits for Massachusetts consumers, including long overdue

relief from high rates, asset divestiture, a highly desirable “standard offer” commitment, emissions reductions, as well as substantial support for renewable, low income and energy efficiency programs, that likely would not otherwise ever be available or only after protracted and uncertain litigation.

- The Agreement is the product of hard fought but informed and consensual compromises by the settling parties and, as such, is a careful balance of competing interests.
- The level of complaints about the terms of an agreement this important and this far reaching is unprecedented and, while a very few parties have argued in favor of conditioning approval of the Agreement on narrow modifications of particular terms that would improve substantially their existing position, no substantial attempt has been made to argue that the Department should reject the Agreement.
- Even if the Department were correct in concluding that a condition it might desire to include would not be fatal to maintaining the delicate balance created behind the October 1, 1996 filing, the inevitable attempts to secure further changes that will flow from the necessity to agree on a change to incorporate any condition will necessarily result in delays that will make January 1, 1998 an impossible target date on which to begin "choice" and the resulting consumer savings.

V.THE DEPARTMENT SHOULD APPROVE THE AGREEMENT

A.The Department Has The Authority To Approve The Agreement

The Department’s authority to approve the Settlement is the same as its authority to implement industry restructuring in general. As the Department has observed, “The courts have consistently stated that the Department's authority to design and set rates pursuant to G.L. c. 164, § 94 is broad and substantial." *Electric Utility Restructuring*, D.P.U. 95-30, p. 41. Indeed, the Supreme Judicial Court has confirmed “the discretion granted [to the Department] under the statute to promote the policy of increased competition in the energy market." *Massachusetts*

Oilheat Council v. Department of Public Utilities, 418 Mass. 798, 805 (1994). The Department's mandate under G.L. c. 164, § 94 is to regulate the electric industry and to issue orders relative to the rates, charges, and practices of an electric company "as the public interest requires." *Massachusetts Electric Company v. Department of Public Utilities*, 419 Mass. 239, 245 (1994). *See Boston Edison Co. v. Department of Public Utilities*, 375 Mass. 1, 47 (1978), *cert. denied*, 439 U.S. 921 (1978); *Incentive Regulation*, D.P.U. 94-158 at 42-43 (1995).[4] This legislative scheme affords the Department the authority and discretion to approve the proposed Settlement so long as it is consistent with the public interest. *Massachusetts Oilheat Council v. Department of Public Utilities*, 418 Mass. at 803-804. Clearly, the public interest is the controlling consideration in the exercise of the Department's regulatory power.[5] *Boston Real Estate Board v. Department of Public Utilities*, 334 Mass. 477, 495 (1956). *Compare Energy Association of New York State v. Public Service Commission*, ___ N.Y.S.2d ___ (November 25, 1996)(agreeing with the conclusion of other courts that "to introduce 'competition into a monopolistic market place and thus lower prices to consumers' is well within the Commissioner's jurisdiction")(slip downloaded from www.dps.state.ny.us).

---

[4] "The Department sets electricity rates (G.L. c. 164, §§ 93 and 94); preapproves contracts for the long-term purchase of electricity (G.L. c. 164, § 94A); maintains oversight over utility affiliate transactions (G.L. c. 164, §§ 76A, 85, 86A, and 94B); reviews and approves distribution and transmission lines with eminent domain authority (G.L. c. 164, §§ 72, 87-91; c. 166, §§ 21-28); approves demand forecast and supply plans (G.L. c. 164, §§ 69G-69R); oversees corporate matters, including the issuance of securities (G.L. c. 164, §§ 3-33); reviews acquisitions and mergers of utilities (G.L. c. 164, § 96); reviews and approves fuel costs and charges, and generating unit performance and procurement practices (G.L. c. 164, § 94G); and ensures that electric utilities fulfill their obligations to serve (G.L. c. 164, §§ 69G-69R, 87-92, and 124-125)." D.P.U. 95-30, p. 6.

[5] *See MCI Telecommunications Corporation v. Federal Communications Commission*, 561 F. 2d 365 (D.C. Cir. 1977), cert. denied 434 U.S. 1040 (1978). "The ultimate test of industry structure in the communications common carrier field must be the public interest, not the private financial interests of those who have until now enjoyed the fruits of *de facto* monopoly." *Id.* at 380. "The United States Supreme Court has dispelled any notions that the administrative agency's primary obligation is the protection of existing certificate holders." *Deacon Transportation, Inc. v. Department of Public Utilities*, 388 Mass. 390, 396 (1983). The public interest is the controlling factor when considering whether to allow increased competition. *See Ecological Fibers, Inc.*, D.P.U. 85-71 (1985); *Petition of Foley*, D.P.U. 86-45/86-144 (1987).

With regard to the specific proposal at hand, the Department has already determined that "[w]hile certain functions associated with the [electric] industry may continue to be best organized as a monopoly, a much more competitive electric generation industry has already started to evolve." *Electric Utility Restructuring*, D.P.U. 95-30, p. 1. Indeed, the Department has determined that public policy requires that the electric industry be restructured — "allowing market forces to play the principal role in organizing electricity supply for all customers" *id.* at 2 — and has adopted principles under which monopoly distribution utilities will deliver electricity purchased by end users in a competitive marketplace in return for a reasonable retail distribution rate. As is discussed *infra*, pp. 13-24, the terms of the Consumers First Agreement are consistent with and advance these principles and, thus, should be approved by the Department.

It is important to observe in response to one of the Department's briefing questions that the exercise of authority to approve the Consumers First Agreement cannot in any sense be considered to be in derogation of the authority of the legislature to undertake any future action it may deem appropriate in regard to restructuring. The legislature's authority to regulate the conduct of an electric utility's business is plenary and that authority cannot be constrained by the act of any administrative agency.

It is, however, possible that approval of the Agreement could result in consequences that would, indirectly, affect future legislative action. First, approval will set into motion actions that will ultimately become irreversible (*e.g.*, sale of NEPCo's assets) and, as such, could result in a change in the environment in which future legislative action could occur. It may be that future action by the legislature that is inconsistent with terms of the Settlement Agreement could affect the overall enforceability of the agreement or result in a delay in both the advent of choice and the resulting savings. *See* Exh. MECo-1, Vol. 1, p. 55 ("In the event of future regulatory or legislative actions which may render any part of this Settlement ineffective, Mass. Electric and NEP shall nevertheless be held harmless and made whole."). Importantly, such an outcome need

not constrain the legislature and, in any event, may be unlikely depending upon the legislative action taken.

Second, it is conceivable that, under some circumstances, approval by the Department could have the effect of providing the Companies with additional grounds, irrespective of their merit, to assert in support of a takings claim regarding a legislative action that they may not necessarily be able to assert in the absence of that action (*e.g.*, the Companies could argue that approval of the Agreement created a "real" regulatory contract). However, such circumstances do not appear to be present here. Approval of the Agreement could not be construed as encouraging the Companies to incur a major expense. Further, the "hold harmless provision" regarding future legislative action can only be interpreted to put the Companies in as good a position as they would have been in the event that there were no Agreement. At most, approval could be construed as encouraging the Companies to implement concessions made in consideration for an agreed upon regulatory treatment under circumstances in which everyone is well aware of the possibility that the legislature may later chose to follow a different course.

C.The Agreement Will Yield Just And Reasonable Rates

Review of the entire record, as presented in Agreement and other evidence, demonstrates not just "the reasonableness" of the Agreement as measured by its consistency "with Department precedent and public policy" established in D.P.U. 95-30 and D.P.U. 96-100, *see Western Massachusetts Electric Company*, D.P.U. 96-8-CC, p. 6 (1996), but it also demonstrates that the specific rates and charges called for under the Agreement will, as required under G.L. c. 164, § 94, be just and reasonable. The record is plain that the Consumers First Agreement will result in lower costs to consumers in both the short and the long run. As is discussed below, the Agreement achieves substantially lower payments to NEPCo for so-called "strandable costs" and to MassElectric for distribution services than could otherwise be secured in the absence of protracted and uncertain litigation. Moreover through its terms on the Standard Offer, the Consumers First Agreement secures a firm supply of power at a lower cost than implicit in today's rates and thereby provides a benchmark with which to assess the rate impact of the settlement as well as the MassElectric's satisfaction of its obligation to serve.

First, unlike the approach adopted by the FERC and the approach proposed by the Department, the Consumers First Agreement guarantees substantial initial savings relative to the rates in effect on October 1, 1996 and ensures that customer bills through 2004 will remain below the level they would have reached had the existing system been maintained.[6] This is accomplished by a combination of a significant reduction in "access charge" payments to NEPCo[7] and the use of the standard offer to capture for all customers a minimum level of the

[6] Given that terms of the Consumers First Agreement require that the proceeds of the required divestiture be treated in a manner to accomplish a prompt credit against the amount of NEPCo's so-called "stranded costs" Exh. MECo-1, Vol. 2, p. 7, it is at most highly unlikely that any set of conditions will put the ten percent savings in jeopardy. To the extent that future tax or fuel price developments affect the agreement, they will by necessity result in rate increases of a lesser magnitude than would occur under the current full pass though approach.

[7] It is instructive to compare the "access charges" that are due under the Consumers First Agreement and those due under the Order 888 approach. Even without making adjustment for the fact that the divestiture requirement in the Agreement will

likely cost cutting benefits from competition. Indeed, although the FERC access charge payment would theoretically end in 2004, the record demonstrates that, without consideration of the additional savings for consumers as a result of NEPCo's agreement to divest its non-nuclear generation facilities, the discounted value of the savings in payments to NEPCo for MassElectric consumers under Consumers First, relative to application of the formula approach available to NEPCo pursuant to FERC Order 888, is more than $314 million. DPU-RR-2. Moreover, the savings for customers are likely to be even greater under every plausible forecast of future market conditions that could affect the agreement. *See* DPU-RR-1 through DPU-RR-8.

Second, the terms of the Agreement concerning the Company's distribution rates are also very favorable to its customers. Under the Agreement, those rates are frozen until January 1, 1998 and, although they are then permitted to increase in the context of other changes that will result in an overall reduction in consumers bills of ten percent,[8] the amount of that increase is

yield substantial additional consumer savings that are not available under the Order 888 approach, it is plain that the savings under the Agreement are substantial.

Year	Order 888	Consumers First	Difference	Annual Savings (millions)
1998	4.15¢	2.80¢	1.35¢	$219
1999	4.07	2.80	1.27	$210
2000	3.99	2.80	1.19	$201
2001	3.93	2.53	1.40	$239
2002	3.89	2.36	1.53	$265
2003	3.83	2.23	1.60	$281
2004	3.76	2.13	1.63	$292
Source	DPU-RR-3, p. 3	Exh. MECo-1, Vol. 2, p. 62		

[8] It should be noted that the increase is permitted only in the event that the "choice" is a reality on that date. Exh. MECo-1, Vol. 1, pp. 25, 8-13.

consistent with recent experience and is supported in the record.[9] Moreover, the agreement contains a binding cap on the Company's earnings at 11.75 percent, which from a customers' vantage is very favorable in comparison to the lack of any "cap" in the incentive plan ordered for Boston Gas as well as the lack of any sharing of earnings below 15 percent. *Boston Gas Company*, D.P.U. 96-50, p. 326 (1996). In the three years from 2001 through 2004, the Agreement caps the Company's distribution rates at the level necessary to retain the inflations adjusted value of the 1998 price reduction. Exh. MECo-1, Vol. 1, pp. 36-37.

Finally, through the Standard Offer, the Agreement locks in seven years of prices for electric power at levels that will at once facilitate the development of a competitive market and allow the Company to meet its obligation to ensure the continuing value of the initial ten percent cut and to have access to sufficient funds to discharge its responsibility to provide reliable distribution service. Exh. MECo-1, Vol. 1, p. 26.

[9] Indeed, even if the Department were to make the wholly unsupported and unrealistic assumption that in the absence of the Agreement the Company's distribution rates would be held constant until the year 2001, the record is clear that the "value" to the Company's customers of the reduced payments to NEPCo is nearly three times greater than the hypothetical "savings" possible under that assumption. *See* DPU-RR-2 and DPU-RR-8.

E. The Agreement Is Consistent With And Advances The Department's Restructuring Principles

1. Provide the broadest possible customer choice.

Under the terms of the Consumers First Agreement, all of MassElectric's customers will have the broadest possible freedom of choice in suppliers. On January 1, 1998, MassElectric's customers will not only have a "standard offer" option providing an initial default power service that will yield ten percent savings off of October 1, 1996 rates, but they will also have the ability to instead elect to receive power from any lawful supplier.[10] *See* Exh. MECo-1, Vol 3, pp. 51-79 (Attachment 9). This freedom will be extended to all of MassElectric's customers, even to those who have entered into agreements that would otherwise have either precluded altogether or resulted in substantial penalties for the exercise of this new freedom. *See* Exh. MECo-1, Vol. 1, pp. 37-40 (MassElectric agreement to waive Service Extension Discount contracts' five year notice requirement, "G" tariff two year notice requirement, and repayment obligations for non-residential DSM participants). Moreover, the agreement incorporates terms that will make "choice" a meaningful reality for the many small customers for which it might otherwise become a reality only at some distant future date.

In particular, the Consumers First Agreement provides specific mechanisms to make "choice" a reality for consumers irrespective of whether they have sophisticated meters and irrespective of whether they are considered to be desirable credit risks by market suppliers of power. The agreement clearly contemplates and includes a proposal to put into place

[10] It is important to note that although it is not a matter addressed in his Consumers First agreement with MassElectric, the Attorney General continues to believe that the entities seeking to compete for sales of power to consumers within the Commonwealth should first be required to obtain some form of certification by the Department to ensure compliance with consumer protection rules, to provide incentives for renegotiation by non-utility generators, and to administer a "bonding" requirement. *Compare*: Proposed 220 C.M.R. § 11.07 with May 24, 1996 Comments of Attorney General in D.P.U. 96-100 and 66 PA.CONS.STAT. ch. 28, § 2809 (1996) appearing in 1996 Pa.Legis.Serv. 1996-138 § 2809 (H.B. 1509)(requirement of license and bonding or other evidence of financial responsibility required).

mechanisms that will allow consumers to exercise choice without being compelled to incur the expense of a new, sophisticated usage meter. *See* Exh. MECo-1, Vol. 3, pp. 60-65 (Attachment 9). Second, the agreement requires that MassElectric put into place a program designed to make sales to low income consumers more attractive to market suppliers. Specifically, MassElectric will be required to offer to market suppliers a program under which it will bear the credit risk of sales to customers on its low income rate (this will be accomplished by guaranteeing payment of outstanding power bills up to an amount equal to that which would be owed under the standard offer). Exh. MECo-1, Vol. 1, p. 45.

3.Provide all customers with an opportunity to share in the benefits of increased competition.

The standard offer requirement in the Consumers First Agreement ensures that the benefits of increased competition will be shared by all customers on the very first day that choice is made available. With the single exception of the price of street lighting service, a service in which the cost of power is a very small part of customers' bills, the Consumers First Agreement calls for all customers — small and large, business and residential — to have an option available that will result in savings of at least ten percent over October 1, 1998 rates. Importantly, while greater savings will likely be available in the "market" for most, if not all customers, the Consumers First Agreement does not require customers to act affirmatively in order to share in the benefits of competition.

5.Ensure full and fair competition in generation markets.

The Consumers First Agreement is calculated to lead to full and fair competition in generation markets. First and foremost, as discussed *supra*, pp. 13-14, the Agreement contains a variety of terms that will make "choice" a reality for many customers for which it would otherwise remain an option to be available only at some point in the future. It expands substantially the size of the retail "market" in which competition may occur on January 1, 1998. Second, the Agreement eliminates effectively MassElectric's affiliate, NEPCo, as a meaningful future competitor in the power market: it requires that NEPCo divest itself of all of its non-nuclear generation plants. Not only does this requirement all but eliminate the most vexing of affiliate transaction concerns, but it also makes available to the market one of the more desirable generation asset portfolios in New England and lowers the already acceptable level of concentration in the ownership of generating capacity. Third, with one limited exception in the circumstance of the ongoing costs associated with any of NEPCo's minority interests in nuclear power plants that cannot be somehow transferred to a market supplier, the "stranded cost" recovery mechanism contained in the Agreement is competitively neutral and, in any event, should not have any adverse impact on the development and/or functioning of a competitive market for power in New England.[11]

Finally, although some disappointed potential market suppliers of power have complained about its pricing in the early years of the Consumers First Agreement, it should be plain that the Standard Offer called for under the Agreement will encourage the development of robust competition, while at the same time providing Massachusetts consumers with an option to

[11] With regard to the development of a competitive market, it is worth noting that, to the extent the capacity is not somehow transferred, the Agreement calls for NEPCo to sell any power from its nuclear capacity at wholesale to non-affiliates. Exh. MECo-1, Vol. 1, pp. 48-50. In this way, the Agreement precludes that capacity from distorting competition in the retail market and, more importantly, makes a significant amount of potential capacity/energy available to new entrants.

avoid most "market risks" over the first six years. Pursuant to the terms of the Consumers First Agreement, all suppliers will have a clearly defined and well structured opportunity to bid to serve any or all of MassElectric's retail load that either through inaction or affirmative decision is served under the Standard Offer. *See* Exh. MECo-1, Vol. 3, pp. 42-49 (Attachment 8). Moreover, the only credible evidence in the record is that the pricing of the Standard Offer is above that observed in the ongoing pilots within New England (*see* Exh. MECo-5; Exh. MECo-6; Exh. WEPCo-1, Sch. JOB-2, pp. 2-3) and is within a range of likely market prices in the near future. Exh. DPU 1-7; Tr. II, pp. 136-139[12]

Indeed, the Department should consider the speculative complaints of Wheeled Electric Power and Freedom Energy in the context of the fact that the Agreement was signed by a number of other potential market suppliers, who, unlike the complainants, have significant generation investments in New England.[13] In these circumstances, the Department should not give any credence to what appears to be the basis of the complaints of Wheeled Electric Power and Freedom Electric: the fact that in a world of excess capacity and aggressive marketing it may not be easy or inexpensive for entities without any generating resources to secure access to the generation resources and a foothold in the market, much less earn a profit. It is an unalterable economic fact that in such circumstances the owners of the generation resources will compete the short-run price down to the short-run marginal cost of the marginal plant. Tr. IV, pp. 100-101 (Goodman). It should be of no concern to the Department that in these circumstances entities without any supply resources will, just like entities with sunk investments,

[12] The Department should give little weight to the New Hampshire testimony by an official from Northeast Utilities that was relied upon by Wheeled Electric Power Company. That testimony was offered in a different context and was intended to answer a different question than that before the Department in this proceeding.

[13] Indeed, considered as an *ex ante* allocation of the risk of future price levels between consumers and market participants, it is plain that the allocation in the standard offer is fair and why it is more acceptable to those with generation assets than those without.

find it difficult, if not impossible, to achieve financial success in the short-run on the basis of the margin between retail prices and wholesale incremental costs.

The Agreement's terms on the Standard Offer reflect a fair, though aggressive *ex ante* assignment, on behalf of MassElectric's customers, of future market risk to potential suppliers. The Department should not consider Wheeled Electric Power Company's request to condition its approval of the Agreement on higher standard offer prices unless it is prepared to also declare unenforceable any existing or future retail power supply contract that contains pricing provisions at or below the Standard Offer pricing set forth in the Agreement. The great bulk of MassElectric's customers are entitled to every bit of much as a good price for power as is any individual customer.

7.Functionally separate generation, transmission, and distribution services.

Given the existing structure within the New England Electric System, the terms of the Consumers First Agreement in large measure achieve completely the Department's goal full functional unbundling. First, MassElectric's primary responsibility will continue to be the provision of distribution services. With the exception of three offerings which it is required to make available under the Agreement — Standard Offer, Basic, and Lifeline Services — MassElectric will no longer "provide" power service. While the Agreement requires that it make these three offerings available as part of its role as the regulated "wires" company, as is explained earlier, the provision of these three services is integrated into and is accomplished in a way that supports the development of a competitive power market. Moreover, the requirement that NEPCo divest its non-nuclear generating assets comes as close as possible to a complete unbundling of the generation function: it all but eliminates any role for NEES in the supply side of the generation market and requires that NEPCo's nuclear and NUG resources be sold at wholesale to non-affiliates. Exh. MECo-1, Vol. 1, p. 48-50.

Second, although the Agreement does not resolve the question of whether or not

transmission services should be "unbundled" to the point where they are the subject of individual "final" sales transactions, it does not preclude any resolution of that question by the Federal Energy Regulatory Commission. It does, however, provide that transmission services by NEPCo at the wholesale level will be unbundled fully and available on a non-discriminatory basis. *See* Exh. MECo-1, Vol. 2, pp. 10-11. Importantly, the Agreement's terms governing the mechanism under which MassElectric will collect any transmission costs it incurs, *see* Exh. MECo-1, Vol. 1, p. 32, protect against any "distinctions between native load and third-party customers ... with respect to transmission pricing, terms, and conditions." *Electric Utility Restructuring*, D.P.U. 95-30, pp. 20-21. Moreover, although NEPCo may continue to have some generating resources ― any minority interests in nuclear power plants it cannot transfer and/or uneconomic contracts for power from non-utility generators ― the divestiture requirement together with the Open Access tariff will bring about a near to complete unbundling of transmission from generation.

Finally, it is important to explain that although the distribution charges contemplated in the Agreement are stated in an amount that bundles together the distribution charge, the stranded cost recovery charge, and the transmission charge, the Agreement does not prelude a further breakout of information on customer bills. Indeed, the Attorney General expects that the Department will prescribe certain generic unbundled price disclosure regulations.[14]

9.Provide universal service.

The Consumers First Agreement includes terms that advance the interest of ensuring some measure of affordibility for low income consumers. First, the Agreement requires that the full value of the existing R2 discount provided to eligible customers be continued in the form of

[14] It is important to explain that the Consumers First Agreement defers until some later date the unbundling of specific distribution functions (*see* Exh. MECo-1, Vol. 1, p. 53) largely because there is no record support for any further unbundling. In fact, the further unbundling of "distribution" functions raises many significant policy questions, such as the universal service impact of allowing individual "network" functions to be unbundled in a context where the cost of those functions may be a significant portion of the bills of customers who are unlikely candidates for an unbundled service offering (*e.g.*, meter reading for small customers in remote locations, collection services for small urban customers).

a reduced distribution charge. Exh. MECo-1, Vol. 1, p. 31. Second, to ensure against any customer being unable to secure service from market suppliers, the Agreement commits MassElectric to make a special "safety net" service available to any low income customer that is no longer eligible for Standard Offer service. Exh. MECo-1, Vol. 1, p. 35. Finally, as described *supra*, p. 14, the Agreement also contains a provision mandating a program designed to encourage market suppliers to participate in the delivery of universal service. Exh. MECo-1, Vol. 1, p. 45.

11.Support and further the goals of environmental regulation.

The Consumers First Agreement is consistent with the Department's responsibility to ensure that the provision of electric service in Massachusetts is accomplished at the least cost and with minimum environmental impact. It contains three environmental provisions: 1) express and enforceable commitments by NEPCo to reduce emissions at its Brayton Point and Salem Harbor generating units; 2) continued funding for demand-side management ("DSM"); and 3) funding designed to commercialize fuel cells and emerging technologies that will provide clean renewable power. Approval of the Consumers First Plan with these three provisions would help the Department achieve a long-standing objective: to accomplish restructuring in a manner that supports and furthers the goals of environmental regulation in a cost effective manner.[15]

The Department can approve these three environmental provisions under its authority as defined by the Supreme Judicial Court. While the Department "does not have responsibility for the protection of the environment," and "has no explicit authority to consider environmental externalities for any purpose...," *Massachusetts Electric Company v. Department of Public*

[15] For example, the Department stated that "increased competition in the electric industry should support and further the efforts of environmental regulators to reduce the environmental impacts of electricity generation." D.P.U. 95-30, p. 25 (1995). The Department also expressed a desire to equalize treatment for all like generators, but stated that "as an economic regulator, it cannot pursue this objective on its own. *Id.*, p. 27. Last May, the Department encouraged "the inclusion of voluntary emission reduction provisions in electric company restructuring plans." D.P.U. 96-100, p. 37 (1996).

Utilities, 419 Mass. 239, 245-246 (1994), it does have the authority as a rate regulator to include in utility rates "reasonable costs to be incurred in protecting the environment, whether mandated or voluntary...." *Id.* The Department should in its order approve Consumers First and find that these three provisions are not likely to raise ratepayer costs above the level expected as a result of tighter future environmental regulation. It should further find that, if any of these three environmental provisions proposed in the Settlement do result in higher costs to ratepayers, they are "reasonable costs to be incurred in protecting the environment" and are in the long term interests of ratepayers.

On the DSM provision of Consumers First, the Department should find that it is likely to save ratepayers money in the long run. Susan E. Coakley testified for the Attorney General and the Massachusetts Division of Energy Resources as an expert on utility DSM programs. Exh. AG-4.[16] The Department should rely on the following points Ms. Coakley made in her testimony:

-The extensive experience with utility DSM programs in Massachusetts over the last six or seven years has demonstrated that DSM programs can be implemented here with substantial long term savings to ratepayers. *Id.* at 2.

-The Department's own monitoring and evaluation studies have shown that, over the lifetime of already-installed utility DSM measures, the average benefit-cost ratio will be approximately 1.7 : 1.[17] In other words, ratepayers' savings will be almost twice their costs. *Id*.

[16] Ms. Coakley is a former Department policy director for conservation and load management who for more than a decade has been actively involved with utility DSM programs in Massachusetts and elsewhere. Id. at 1.

[17] DSM would also improve the environment by decreasing the utilization of power plants. However, the Supreme Judicial Court has found that the Department "has no explicit authority to consider environmental externalities for any purpose." *Massachusetts Electric Company v. Department of Public Utilities*, 419 Mass. 239, 245-246 (1994). Therefore, Ms. Coakley's analysis considers only the rate benefits of DSM. The Department's order should be similarly constrained.

-DSM benefits should continue during the transition. While utility DSM programs should change and reflect market transformation strategies in a restructured market, the programs need to continue because existing market barriers will not disappear anytime soon. *Id.*

-DSM also would benefit ratepayers by providing fuel diversity benefits that reduce ratepayers' risks of future energy price increases. *Id.*

Ms. Coakley concluded that, assuming effective program design continues, the proposed Settlement's funding of DSM would be very much in the long term interest of ratepayers. *Id.* No party challenged this conclusion on the record. Based on this record, the Department should find that the DSM provision of Consumers First would yield rate benefits to ratepayers over the long term, and should approve the proposal.

13.Rely on incentive regulation where a fully competitive market cannot exist, or does not yet exist.

The Consumers First Agreement contains effective incentive based schemes governing both future distribution rates and future stranded cost mitigation. First, with regard to the incentives governing rates for distribution service, the Agreement requires the Company to freeze its current rates until January 1, 1998[18] (at which time consumers will get a ten percent reduction in their bills, while the Company will be permitted to increase its distribution prices by an amount well in line with past awards and supported by evidence). The Company is then required to freeze its distributions rates until the end of the year 2000, at which time they will be subject to a cap requiring that they remain at the level necessary to maintain the "real" price of

[18] While the Attorney General does not suggest that the Department should give any particular weight to the Company's withdrawal earlier this year, in response to a request by the Department, of its announced intention to file a base rate case, he does submit that it should be considered in the context in which the Department evaluates the reasonableness of the $45 million or three percent distribution rate increase called for in 1998 at the time that consumers' overall bills will be reduced by a minimum of ten percent.

service under the standard offer at ten percent less than the price of electric service in effect on October 1, 1996. *See* Exh. MECo-1, Vol. 1, pp. 36-37. The result of these commitments is that the "real" price of MassElectric's distribution service — today, the lowest in the Commonwealth — is not likely to increase at all during the nine year period from October 1995 through the end of 2004. Moreover, although the Agreement contains two performance based mechanisms designed to ensure that the Company maintain its existing level of reliability and customer satisfaction, it contemplates expressly subsequent application of a generic performance incentive program the Department might adopt as a part of or subsequent to its restructuring effort. Exh. MECo-1, Vol. 1, p.29 & Vol. 3, pp. 37-40 (Attachment 7).

With regard to the incentives created for NEPCo to mitigate its "strandable costs," the Agreement provides a schedule of incentive payments tied to the cumulative average of the access charge over the years from 1998 through 2004. It is important to emphasize that the implicit rate of return for the next twelve years on the equity component of the capital that NEPCo has invested in "strandable assets" is set at a base level of 9.64 percent. Any increase in NEPCo's profitability is tied explicitly to its success in mitigating the level of its access charge. Although NEPCo has the smallest "strandable cost" problem of all the Commonwealth's investor owned utilities, even if it reduced the cumulative average of the access charge to a level below 1¢, it will earn no more profits than it would have if it had not divested and achieved only a twelve percent return. As the Department is well aware, this is a level of profitability well below that experienced by NEPCo within the recent past. The incentive should, however, be sufficient to engender solid mitigation efforts by NEES. *See* DPU-RR-5 through DPU-RR-8 (demonstrating that even under the most favorable outcomes, while the mitigation incentive should be sufficient to encourage exemplary performance, the value of any incentive payments is small in relationship to the value of the actual mitigation).

VII.CONCLUSION

WHEREFORE, for all of the foregoing reasons, the Attorney General urges the Department to approve the Consumers First Agreement.

RESPECTFULLY SUBMITTED
SCOTT HARSHBARGER
ATTORNEY GENERAL

by: _____
George B. Dean
Joseph W. Rogers
William M. McAvoy
Frank P. Pozniak
Assistant Attorneys General
Regulated Industries Division

Edward G. Bohlen
Environmental Protection Division

200 Portland Street
Boston, MA 02114
(617) 727-2200

Dated: December 17, 1996